



Financial Statements
December 31, 2011

Northeast Council of Governments

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CPAs & BUSINESS ADVISORS

Independent Auditor's Report

The Board of Directors
Northeast Council of Governments
Aberdeen, South Dakota

We have audited the accompanying financial statements of the Northeast Council of Governments as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of Northeast Council of Governments's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Northeast Council of Governments as of December 31, 2011, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 13, 2012, on our consideration of the Northeast Council of Governments's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Eide Bailly LLP

Aberdeen, South Dakota
July 13, 2012

This section of the financial report represents management's discussion and analysis of the Northeast Council of Governments's (NECOG) financial performance during the year ended December 31, 2011. This report is presented to provide additional information about NECOG and to meet the requirements of GASB 34. This analysis should be read in conjunction with the independent auditor's report, financial statements, and the notes to the financial statements.

Nature of Operations for the Organization

NECOG is a governmental entity; the boundaries, counties, and cities included were established under Executive Order 70-7 by the State of South Dakota's governor's office. NECOG currently serves twelve counties in the Aberdeen, South Dakota area (northeastern South Dakota), initiating, guiding, and providing strategic planning within the area it serves. The primary objective of NECOG is to provide specific planning for rural economic development through projects to enhance the economic environment and improve or maintain the quality of life in the area it serves.

Financial Statements

The financial statements used by NECOG include a statement of net assets (similar to a balance sheet). The statement of net assets reports all financial and capital assets for NECOG. The statement is presented in a format where assets equal liabilities plus net assets, formerly known as equity. Assets and liabilities are presented in order of liquidity. Current assets are those that are convertible to cash within one year.

The financial statements also include a statement of revenues, expenses and changes in net assets (similar to an income statement). This statement includes revenues; such as federal grants, administrative fees, contract and local revenues and interest income and expenses; such as payroll related costs, professional fees and other. The focus of the statement of revenues, expenses and changes in net assets is to show the change in net assets.

A statement of cash flows is also included, which discloses net cash from or used for operating activities, nonoperating grants received, investments in capital assets and other investing activities.

The notes to the financial statements provide additional information essential to understanding the financial statements.

Statement of Net Assets

The following table reflects the condensed statement of net assets compared to the prior year:

	2011	2010
Assets		
Cash and cash equivalents	\$ 87,541	\$ 118,666
Certificates of deposit	1,606,885	1,446,384
Accounts receivable	36,619	128,806
Due from NECOG Development Corporation	9,311	7,568
Accrued interest receivable	12,269	18,058
Prepaid expenses	3,943	3,453
Total current assets	1,756,568	1,722,935
Capital Assets, Net of Accumulated Depreciation	27,080	34,921
	<u>\$ 1,783,648</u>	<u>\$ 1,757,856</u>
Liabilities		
Accounts payable	\$ 970	\$ 34,185
Accrued annual leave	16,350	14,497
Unearned revenue	80,411	219,894
Total current liabilities	97,731	268,576
Net Assets		
Invested in capital assets	27,080	34,921
Net assets - unrestricted	1,658,837	1,454,359
Total net assets	1,685,917	1,489,280
	<u>\$ 1,783,648</u>	<u>\$ 1,757,856</u>

Major Factors Affecting the Statement of Net Assets

Current assets increased by \$33,633. This increase is primarily due to the increase in certificates of deposits as additional money from the collection of accounts receivable was invested.

Total liabilities decreased \$170,845. This is due primarily to a decrease in unearned revenue related to the timing of contract revenue collection and closing of contracts from ARRA projects.

Total liabilities and net assets increased \$25,792, which was primarily related to the decrease in unearned revenues and the change in net assets of \$196,637 for the year ended December 31, 2011.

Statement of Revenues, Expenses and Changes in Net Assets

The following table compares the revenues and expenses for the current and previous fiscal years:

	2011	2010	% Change
Revenues			
Federal grants and funding revenues	\$ 138,905	\$ 174,469	-20%
Contract revenues	397,418	206,021	93%
Local revenues	130,259	128,145	2%
NECOG Development Corporation			
administrative fees	80,241	74,282	8%
Interest income	24,757	33,545	-26%
Other operating revenues	99	1,053	-91%
Total revenues	771,679	617,515	25%
Expenses			
Salaries	277,149	267,120	4%
Payroll taxes and benefits	61,920	60,100	3%
Staff travel	12,637	18,124	-30%
Directors fees and travel	1,873	1,405	33%
Insurance	8,752	6,572	33%
Professional fees	52,137	85,219	-39%
Office rent	20,268	20,268	0%
Equipment rental and maintenance contracts	4,087	4,241	-4%
Expendable equipment purchases	6,735	6,771	-1%
Utilities and telecommunications	7,336	6,526	12%
Membership and conference registration	6,057	5,569	9%
Office expenses	6,831	6,195	10%
Depreciation expense	7,841	4,492	75%
Loss on sale of assets	-	100	-100%
RLF match expense	100,300	-	0%
Miscellaneous expense	1,119	1,982	-44%
Total expenses	575,042	494,684	16%
Changes in Net Assets	196,637	122,831	60%
Net Assets - Beginning	1,489,280	1,366,449	
Net Assets - Ending	\$ 1,685,917	\$ 1,489,280	

Major Factors Affecting the Statement of Revenues, Expenses and Changes in Net Assets

Contract income increased \$191,397 (93%), largely due to an increase in infrastructure projects in the region still in progress due to the Federal ARRA funds. Federal grants and funding revenue decreased \$35,564 (20%) due to a decrease in the DOJ grant activity. Total expenses increased \$80,358 (16%), mostly due to a RLF match expense to NECOG Development Corporation in the amount of \$100,300.

Net assets at the beginning of the year was \$1,489,280 and at the end of the year was \$1,685,917 (including invested in capital assets), resulting in an increase in net assets (net income) of \$196,637.

Capital Asset and Debt Administration

Capital Assets – During 2011, NECOG made no investment in their capital assets.

Debt Outstanding – NECOG had no debt outstanding in 2011 or 2010.

Currently Known Facts, Decisions or Conditions

NECOG has made a commitment to the NECOG Development Corporation to provide matching funds up to \$187,500 as they make qualifying loans under their Intermediary Relending Program beginning in 2011. Through December 31, 2011, \$100,300 of the \$187,500 committed had been provided to NECOG Development Corporation.

Financial Contact

If you have any questions about this report or need additional financial information, contact the Northeast Council of Governments Accountant at (605) 626-2595 or by writing to Northeast Council of Governments, 2201 6th Avenue SE, Suite 2, PO Box 1985, Aberdeen, SD 57402-1985.

Northeast Council of Governments
Statement of Net Assets
December 31, 2011

Assets

Current Assets

Cash and cash equivalents	\$ 87,541
Certificates of deposit	1,606,885
Accounts receivable	24,934
Grants receivable from other governments	11,685
Due from NECOG Development Corporation	9,311
Accrued interest receivable	12,269
Prepaid expenses	3,943
	<hr/>
Total current assets	1,756,568

Noncurrent Assets

Capital assets, at cost:	
Automobiles	46,250
Leasehold improvements	36,787
Office equipment	31,624
	<hr/>
	114,661
Less accumulated depreciation	(87,581)
	<hr/>
Total noncurrent assets	27,080

\$ 1,783,648

Liabilities and Net Assets

Current Liabilities

Accounts payable	\$ 970
Accrued annual leave	16,350
Unearned revenue	80,411
	<hr/>
Total current liabilities	97,731

Net Assets

Invested in capital assets	27,080
Unrestricted net assets	1,658,837
	<hr/>
Total net assets	1,685,917
	<hr/>
	<u><u>\$ 1,783,648</u></u>

Northeast Council of Governments
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended December 31, 2011

Operating Revenues	
Contract revenues	\$ 397,418
Federal grant and funding revenues	66,905
Local revenues and support	130,259
NECOG Development Corporation administrative fees	80,241
Other operating revenues	99
	<hr/>
Total revenues	674,922
	<hr/>
Operating Expenses	
Salaries	277,149
Payroll taxes	21,202
Employee benefits	40,718
Staff vehicle expense	3,807
Travel	8,829
Directors fees and travel	1,873
Insurance	8,752
Professional fees	52,137
Office rent	20,268
Equipment rentals	629
Office supplies	6,735
Maintenance contracts	3,459
Utilities and telecommunications	7,336
Memberships and conferences	6,057
Postage	3,043
Subscriptions and publications	3,788
Depreciation expense	7,841
Miscellaneous and other expenses	1,119
	<hr/>
Total operating expenses	474,742
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Operating Income	200,180
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Nonoperating Revenue (Expense)	
Grant income	72,000
Interest income	24,757
RLF match expense	(100,300)
	<hr/>
Total nonoperating revenue (expense)	(3,543)
	<hr/>
Changes in Net Assets	196,637
Net Assets, Beginning of Year	1,489,280
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Net Assets, End of Year	\$ 1,685,917
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Northeast Council of Governments

Statement of Cash Flows

Year Ended December 31, 2011

Cash Flows from Operating Activities	
Receipts from customers	\$ 400,963
Receipts from grants and federal funding	91,230
Receipts from local revenues and support	133,591
Payments to suppliers and others	(182,739)
Payments to employees	(316,014)
Other receipts	99
	<u>127,130</u>
Net Cash from Operating Activities	<u>127,130</u>
Cash Flows used for Noncapital Financing Activities	
RLF match expense paid to NECOG Development Corporation	(100,300)
Nonoperating grants received	72,000
	<u>(28,300)</u>
Net Cash used for Noncapital Financing Activities	<u>(28,300)</u>
Cash Flows used for Investing Activities	
Redemption of certificates of deposit	790,782
Purchase of certificates of deposit	(951,283)
Interest received	30,546
	<u>(129,955)</u>
Net Cash used for Investing Activities	<u>(129,955)</u>
Net Change in Cash and Cash Equivalents	(31,125)
Cash and Cash Equivalents - Beginning	<u>118,666</u>
Cash and Cash Equivalents - Ending	<u><u>\$ 87,541</u></u>
Reconciliation of Operating Income to	
Net Cash from Operating Activities	
Operating income	\$ 200,180
Adjustments to reconcile operating income to:	
Depreciation	7,841
Change in assets and liabilities:	
Accounts receivable	92,187
Due from NECOG Development Corporation	(1,743)
Prepaid expenses	(490)
Accounts payable	(33,215)
Accrued annual leave	1,853
Unearned revenue	(139,483)
	<u>127,130</u>
Net Cash from Operating Activities	<u><u>\$ 127,130</u></u>

Note 1 - Nature of Operations and Significant Accounting Policies

The accounting policies of the Northeast Council of Governments (NECOG) conform to accounting principles generally accepted in the United States of America applicable to governmental units. The following is a summary of the significant policies.

Reporting Entity

NECOG is a governmental entity; the boundaries, counties, and cities included were established under Executive Order 70-7 by the State of South Dakota's governor's office. NECOG currently serves twelve counties in the Aberdeen, South Dakota area (northeastern South Dakota), initiating, guiding, and providing strategic planning within the area it serves. The primary objective of NECOG is to provide specific planning for rural economic development through projects to enhance the economic environment and improve or maintain the quality of life in the area it serves.

The staff of NECOG provides technical and professional assistance to member units of government in writing grant proposals, comprehensive planning, analyzing local resources, and similar assistance. The financial statements presented in this report represent all the funds and fiscal activities under the control of the Board of Directors, through a five member Executive Board elected from the full board of NECOG. NECOG is governed by a board consisting of county commissioners, city officials, and private citizens. Control is determined by oversight, legal responsibilities, and financial accountability.

The accompanying financial statements have been prepared from records pertaining to and including all the funds, operations, activities, and financial affairs of NECOG.

Basis of Accounting and Financial Statement Presentation

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America on the accrual basis of accounting; revenues are recognized when earned and expenses are recognized when incurred.

The accounts are organized on the basis of funds. During 2011, all activities were accounted for through the general fund, there were no separate special purpose funds in 2011. The operations of the general fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. Governmental resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. For 2011, NECOG's funds are grouped into one broad fund category and fund type as follows.

Proprietary Funds

Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The General Operating Fund was the only enterprise fund maintained by NECOG for 2011. It is the only major fund for financial reporting purposes.

Financial Accounting Standards Board Statements and Interpretations issued prior to November 30, 1989 generally are followed in the financial statements to the extent that those standards do not conflict with or contradict pronouncements of the Governmental Accounting Standards Board. NECOG does not follow FASB Statements and Interpretations issued after November 30, 1989.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of NECOG's general fund are contract revenues from the administering of grant programs on the behalf of other governmental entities and annual dues received from its member cities and counties. Operating expenses for the fund includes all administrative costs of the entity and depreciation expense. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. When both restricted and unrestricted resources are available for use, it is NECOG's policy to use restricted resources first, then unrestricted resources as they are needed.

Cash and Cash Equivalents

For purpose of the statement of cash flows, NECOG considers all highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents; all cash accounts and unrestricted temporary cash investments at the financial statement reporting date were considered to be cash equivalents in the accompanying statement of net assets.

Accounts Receivable, Unearned Revenue and the Recognition of Revenue

Resources from grants are recorded as revenue, when the related costs are incurred using the percentage of completion method, measured by the ratio that costs incurred bears to total estimated costs. Adjustments to cost estimates are made periodically. If the funding received under a grant is less than the revenue earned, based on matching requirements and costs incurred, the revenue is accrued (recorded as revenue) and presented as an account receivable in the accompanying financial statements. If funding received under a grants exceeds the revenue earned, based on costs incurred, the revenue is deferred (not recognized as revenue until such time in the future when earned) and presented as unearned revenue in the accompanying financial statements.

Local funding provided by member counties and cities is recorded as revenues of the year to which the funding commitment is related. These revenues are applied as local funding match to individual grants on the basis of total expenditures of the grant in the cost sharing ratio specified in the grant agreement.

Federal funding is recorded as revenues by individual grant for the federal share of costs incurred to date determined by the cost-sharing ratio specified in the grant agreement or contract. If the funding received for a grant is less than the revenue earned, based on cost-sharing ratio, the revenue is accrued (the accrual is recorded as revenue) and presented as a receivable in the accompanying financial statements. If the funding received for a grant exceeds the revenue earned, based on cost-sharing ratio, the revenue is deferred (not recognized as revenue and deferred) and presented as unearned revenue in the accompanying financial statements.

Indirect Cost System

Indirect costs are applied or allocated to individual grants based upon a fixed ratio or percent of direct salaries, payroll taxes, and employee benefits charged to a grant. This rate is reviewed annually and revised as necessary in an attempt to minimize over- or under-applied indirect costs. The resulting over- or under-applied indirect costs for year end are charged or credited, as appropriate, are carried forward to the next year's indirect cost allocation.

The indirect costs system has previously been approved by the U.S. Department of Justice and is operated in accordance with guidelines established by OMB Circular A-87, Cost Principles for State and Local Governments. The indirect cost rate for 2011 was 37% of direct salaries, payroll taxes, and employee benefits.

Capital Assets and Depreciation

Capital assets include vehicles, leasehold improvements, office and computer equipment, and software and are recorded at cost and depreciated over their estimated useful lives. NECOG uses a capital asset capitalization policy of \$5,000; items costing less than this amount (individually) are charged as expense to current year operations, as expendable equipment or supplies. Major renewals and betterments are capitalized in the capital asset accounts and depreciated; while replacements, maintenance, and repairs, which do not improve or extend the lives of respective assets are charged to current year operations as repairs and maintenance expense. Depreciation is computed on the straight-line method using estimated useful lives of three to five years.

Accrued Annual Leave and Employee Benefits

The cost of compensated leave and employee benefits are accrued as they are vested to the employee.

Self-Insurance – Unemployment Benefits

NECOG is under the self-insurance method for paying unemployment claims. Under this method, NECOG pays unemployment benefit claims to the State system as they are billed rather than contributing to the State system. Costs resulting from claims are charged to income as expenses when incurred. There were no unemployment benefit costs during 2011.

Estimates

Management uses estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from the estimates that were used.

Income Taxes

NECOG is a governmental entity exempt from federal income taxes; therefore, no provision for income taxes has been presented in the accompanying financial statements. The State of South Dakota does not have an income tax.

Note 2 - Deposits and Investments

NECOG's deposits are made and held in qualified public depositories. In South Dakota, qualified depositories are required by SDCL 4-6A to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100% of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA.

NECOG maintains its cash balances, savings accounts, and certificates of deposit at financial institutions in the general local area. The cash balances are held in institutions insured by the FDIC or NCUA. All cash balances, including interest earned, where applicable, have market values at December 31, 2011 that are substantially the same as the carrying value in the accompanying financial statements. Deposits are reported at cost plus interest, if the account is of the add-on type.

Custodial Credit Risk Deposits: The risk that, in the event of a bank failure, NECOG's deposits may not be returned. NECOG does not have a formal deposit policy for the custodial credit risk, but maintains its cash accounts in several commercial bank deposit accounts to help lower this risk. NECOG believes it is not exposed to any significant credit risk on cash and cash equivalents and NECOG has not experienced any losses on such accounts.

The actual bank balances of NECOG were as follows:

	<u>Bank Balance</u>
Insured (FDIC)	\$ 1,706,044
Uninsured	<u>-</u>
Total deposits	<u>\$ 1,706,044</u>
NECOG's carrying amount of deposits at December 31	<u><u>\$ 1,694,426</u></u>

Note 3 - Capital Assets

A summary of changes in capital assets for the year ended December 31, 2011 is as follows:

	<u>Balance 01/01/11</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance 12/31/11</u>
Cost				
Automobiles	\$ 46,250	\$ -	\$ -	\$ 46,250
Leasehold improvements	36,787	-	-	36,787
Office equipment	31,624	-	-	31,624
	<u>\$ 114,661</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 114,661</u>
Accumulated Depreciation				
Automobiles	\$ 46,250	\$ -	\$ -	\$ 46,250
Leasehold improvements	10,591	5,613	-	16,204
Office equipment	22,899	2,228	-	25,127
	<u>\$ 79,740</u>	<u>\$ 7,841</u>	<u>\$ -</u>	<u>\$ 87,581</u>

The provision reported above of \$7,841 is the depreciation expense charged to current year operations.

Note 4 - Retirement Plan

Employees of NECOG participate in the South Dakota Retirement System (SDRS), a cost-sharing, multiple employer public employee retirement system established to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability, and survivor benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering, and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SDRS, PO Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Covered employees are required by State statute to contribute the following percentages of their salary to the plan; Class A members, 6% of salary; Class B Judicial Members, 9% of salary; and Class B Public Safety Member, 8% of salary. Cost allocations of retirement benefits, as with other employee benefits, are allocated to specific projects, programs, and grants based on payroll cost allocations. NECOG's share of contributions made to the SDRS for the years ended December 31, 2011, 2010 and 2009 were \$16,241, \$15,523 and \$14,812, respectively.

Note 5 - Operating Lease - Lease Commitment

NECOG leases its office facilities. The lease agreement is for monthly rentals of \$1,689 per month, through the end of May 2015. The total rent for the year ending December 31, 2011 was \$20,268.

Future minimum lease payments for the remaining lease terms are as follows:

<u>Years Ending December 31,</u>	<u>Amount</u>
2012	\$ 20,268
2013	20,268
2014	20,268
2015	8,445
	<u>\$ 69,249</u>

Note 6 - Related Party Transactions

In January 1995, NECOG spun off the Revolving Loan Fund, forming a new separate corporation, under Internal Revenue Code Section 501 (c)(3). The new corporation is NECOG Development Corporation (Development Corporation) and it issues its own separate annual financial report.

NECOG charges an administrative fee for the services it provides and expenses incurred for the Development Corporation. NECOG shares its offices with the Development Corporation; however, the Development Corporation is not a component unit of NECOG.

NECOG provides services and office space to the Development Corporation. During the year 2011, NECOG charged the Development Corporation administrative fees totaling \$80,241. NECOG also had a receivable from the Development Corporation totaling \$9,311 as of December 31, 2011. See also Note 9.

Note 7 - Risk Management

Liability and casualty insurance are carried for risks of loss related to torts, theft, or damage to property; and errors and omissions of public officials through a commercial insurance carrier. All employees of NECOG are also covered by workers compensation insurance. NECOG reviews insurance coverage annually to determine if any additions or revisions need to be made for future years.

Note 8 - Concentration

NECOG receives a substantial amount of its revenues or support from federal, state, and local governments. A reduction in the level of funding or this support, if it were to occur, may have a significant negative impact on NECOG's operations and activities.

Note 9 - Commitments

NECOG has made a commitment to the NECOG Development Corporation to provide matching funds as the Development Corporation makes qualifying loans under their Intermediary Relending Program in an amount up to \$187,500 beginning in 2011. Funds drawn down by the Development Corporation during the year ended December 31, 2011 totaled \$401,200 with the 25% match provided by NECOG totaling \$100,300. This is reflected as RLF match expense on the statement of revenues, expenses and changes in net assets.

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
Northeast Council of Governments
Aberdeen, South Dakota

We have audited the accompanying financial statements of Northeast Council of Governments as of December 31, 2011 and for the year then ended, and have issued our report thereon dated July 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of NECOG is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered NECOG's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NECOG's internal control over financial reporting. Accordingly, we do not express such an opinion on the effectiveness of NECOG's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and; therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the accompanying auditor's comments, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying auditor's comments as item 2011-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether NECOG's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests did not disclose any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

NECOG's response to the finding identified in our audit is described in the accompanying auditor's comments. We did not audit NECOG's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the South Dakota Department of Legislative Audit, Board of Directors and management of the Northeast Council of Governments, others within the entity, and federal awarding and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink that reads "Eric Sully LLP". The signature is written in a cursive, flowing style.

Aberdeen, South Dakota
July 13, 2012

Prior Audit Findings

Finding 2010-1 Preparation of Financial Statements, Footnotes and Journal Entries

Material Weakness

Condition: Northeast Council of Governments does not have an internal control system designed to provide for the preparation of the financial statements being audited, including all necessary adjustments and related disclosures.

Status: This finding has not been resolved as of December 31, 2011 and is restated as current year finding 2011-1.

Current Audit Findings and Recommendations

Finding 2011-1 Preparation of Financial Statements, Footnotes and Journal Entries

Material Weakness

Condition: Northeast Council of Governments requested the external auditors to prepare the financial statements, and related footnotes and disclosures for the year ended December 31, 2011. As a part of the financial statement preparation process, at times, the auditors propose audit adjustments that are not identified as a result of NECOG's existing internal controls and; therefore, could result in a material misstatement of the NECOG's financial statements.

Criteria: NECOG's internal control structure should be designed to provide for the preparation of the financial statements and footnotes, which includes having an adequate system for recording and processing entries material to the financial statements being audited, in accordance with generally accepted accounting principles.

Cause: NECOG does not have adequate staff trained to prepare financial statements and the related footnotes in accordance with generally accepted accounting principles, which could cause the need for auditors to, at times, propose material journal entries.

Effect: This condition may affect NECOG's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Recommendation: This circumstance is not unusual in an organization of this size. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations. Also, a thorough review of the transactions should take place prior to the beginning of the audit, to ensure that generally accepted accounting principles have been followed, especially for transaction types infrequent in occurrence.

Management Response: Management will review for propriety the draft financial statements and footnotes prepared by the auditor and review all recommended audit adjusting entries proposed by the auditor. Due to NECOG's size, management accepts the risk associated with preparation of the final audited financial statements by the independent auditor.